

DAIRY INSTITUTE *of California*

September 19, 2006

The Honorable A.G. Kawamura, Secretary
California Department of Food and Agriculture
1220 N Street
Sacramento, CA 95814

Dear Secretary Kawamura:

The purpose of this letter is to respectfully request that you deny the petition submitted on September 13, 2006 by Milk Producers Council. For similar reasons, we also ask you to reject the September 13th request by Western United Dairymen to delay implementation of the hearing decision issued on July 21, 2006.

Milk Producers Council is seeking another hearing on the Class 4b pricing formula, which was the subject of an exhaustive two-day hearing in early June of this year. The decision stemming from that hearing has yet to be implemented, so calling a hearing at this time is, at the least, premature. Moreover, there has been no new information pertinent to the costs of dairy product manufacturing that would warrant the calling of a new hearing.

Both Milk Producers Council and Western United Dairymen make reference to a newly published study by Cornell University, which was published on the Cornell Program on Dairy Markets and Policy (CPDMP) website. Western United is suggesting that there are large discrepancies between the Cornell cost data and the cost data that has been collected by the California Department of Food and Agriculture's Dairy Marketing Branch. These "discrepancies," Western United suggests, should be the basis for delaying implementation of the recent hearing decision. Milk Producers Council appears to be arguing that the Cornell study is a new and relevant source of information and therefore calling a new California milk pricing hearing is necessary. The rationales offered by both organizations are faulty.

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A closer examination of the Cornell study and the testimony that was given by Dr. Mark Stephenson at the recent federal order hearing shows quite plainly that there is no discrepancy between the Cornell numbers and the data contained in the Department's own cost studies. In order for a discrepancy to exist, the CDFA data and the Cornell data would have to be showing different estimates of the same cost of processing. They do not. The CDFA data shows the cost of processing milk into dairy products in California. The Cornell study, on the other hand, shows the cost of processing dairy products for a sample of plants located outside California. This is a key point. The Cornell study did not survey any California plants and plant operators' experience has shown that cost structures are different in California than in many other parts of the country.

Dr. Mark Stephenson, the author of the Cornell study, testified to some of the methodological differences at the reconvened federal order hearing last week: *"The methodology used to collect and summarize the data are very similar to the methodology used by the California Department of Food and Agriculture (CDFA) in their annual plant surveys. There are three primary differences from CDFA's results that bear mention: I do not have audit authority to collect data from plants, I do not calculate a current value of assets from schedules of economic depreciation and, my sample of plants represent a smaller proportion of the population than California's annual survey (emphasis added)."*

Dr. Stephenson is not suggesting that these differences result in a superior methodology, but rather that the CDFA methodology is superior to that which he has used. He states later in his testimony that *"...The basic idea of statistics is that you want to extrapolate from the data you have collected to make general conclusions about the larger population from which the data sample was derived...This model is an accurate description of some situations, but not the [whole] U.S. dairy industry. The CDFA data essentially sidesteps the issue as they collect data from very nearly all plants processing the products of interest in their state. This is the difference between a "sample statistic" - what I have collected - and a "population parameter" - what CDFA collects (emphasis added)."*

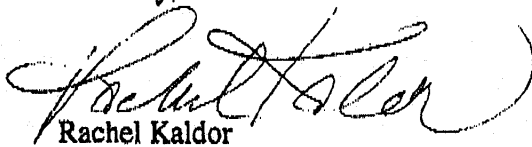
In essence, what Dr. Stephenson is saying is that the CDFA cost study methodology is the "gold standard" with respect to manufacturing cost studies, and that he has attempted to mimic it where he could. However, he had to "settle" for less complete information because he did not have either the authority or the capability to gather the more complete data set. In his testimony, Dr. Stephenson went on to point out how the sample statistics he collected can differ from the estimated population parameters that one can calculate given enough information. With respect to cheese, he reported a weighted average sample manufacturing cost of \$0.1638 per pound, but testified that the estimated weighted average cost for the population was \$0.2028 per pound due to the sampling methodology. He was unable to provide a similar population estimate for the sample dry whey weighted average of \$0.1941 because of limitations in the information available to him. Given the nearly *four cent per pound* difference between the Cornell study's sample average and its estimated population average for cheese costs, it would be reasonable to assume that there would be differences between the sample and population estimates for dry whey as well.

The bottom line here is that there is no reason to doubt the validity or appropriateness of the CDFA cost study data as being representative of the costs of manufacturing the surveyed products. Likewise, there is no discrepancy between the CDFA and Cornell data that needs to be addressed. The Cornell study summarized costs from a different population of plants and is of questionable relevance to the CDFA hearing proceedings. Moreover, the CDFA dry whey costs are consistent with the Cornell surveyed costs for similar-sized plants. The testimony of Dr. Mark Stephenson at the recent federal order hearing affirms the appropriateness and the superiority of the CDFA cost study methodology. Therefore, the Cornell study does not bring anything "new or better" that should be considered by the Department in formulating California dairy policy.

The charge by Milk Producers Council of hearing panel bias is, of course, ridiculous. The panel consists of trained economists, statisticians, and auditors who formulate informed opinions and findings based on the evidence available to them. The fact that a finding rendered in one hearing is consistent with a finding rendered in a subsequent hearing is not evidence of bias, but rather, of a lack of new compelling testimony that would lead the panel members to reach a different conclusion. It is incumbent upon those giving testimony at milk pricing hearings to submit well-documented, convincing, and accurate evidence to support their position. Unsupported assertions, allegations, or innuendo do not constitute evidence, and it should not be surprising to hearing participants when such testimony fails to persuade trained panel members to change findings that have been founded on legitimate evidence and sound economic principles. On numerous past occasions, Dairy Institute has been unsuccessful at persuading the hearing panel to adopt one or more of our proposed changes to the formulas. With some of these, the Department's rationale for rejecting our proposals has been virtually identical to the rationale used in rejecting earlier incarnations of the same proposed changes. Rather than charge the panel with bias, we have endeavored to come to subsequent hearings with new, more convincing evidence. We would encourage other organizations to do the same.

In summary, there is nothing contained in the September 13th letters from Milk Producers Council and Western United Dairymen that provides a sound rationale for delaying implementation of the recent Class 4a/4b hearing decision or for calling a new Class 4b hearing. We urge the Department to reject both organizations' requests.

Sincerely,



Rachel Kaldor
Executive Director

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Kelly Krug
David Ikari